No. 20679

IN THE

United States Court of Appeals

FOR THE NINTH CIRCUIT

STEPHAN RIESS and THELMA MCKINNEY RIESS,
Appellants,

vs.

C. W. MURCHISON, SIMI VALLEY DEVELOPMENT COMPANY, *et al.*,
Appellees.

APPELLANTS' REPLY BRIEF.

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Appellees.

APPELLANTS' REPLY BRIEF.

Preliminary.

In its earlier opinion in this case (329 F. 2d 635, 644), this court held that Appellees' right to arbitration was to be determined by California law.

> "*If* the present case is one which is otherwise proper for arbitration the buyers are entitled to have the question of sufficiency settled by arbitration. Whether it is such a case must be determined on the facts relative to the buyers' conduct. See Calif. Code Civ. Proc., Sec. 1281; *Bertero v. Superior Court,* 216 ACA 251, 30 Cal. 719 (1963); *Jordan v. Friedman,* 72 Cal. App. 2d 726, 165 P. 2d 728 (1946). And the determination *must be governed by the pertinent California cases* and statutes, for the contract is not one involving commerce . . . and the question relates to performance and discharge and, therefore, under

the pertinent authorities is governed by the substantive law of California, the place of performance."

No California decision holds that a provision for arbitration survives a repudiation of the contract. As will be shown hereafter, the California decisions, including *Bertero v. Superior Court,* 216 Cal. App. 251, hold that provisions for arbitration are repudiated by a party's repudiation of the contract as a whole. It is true that an English decision, expressly at odds with earlier cases, and dealing with a most broad arbitration clause, holds that the arbitration clause survived a total breach of other provisions; but the opinions of all of the Lord's Justice show that their decision is based, at least in part, on the scope of the particular arbitration clause. California has not followed the English decision.

The court's attention is respectfully directed to Appellee's agreement with Appellants' contention that the provision for arbitration applies only to determining "the sufficiency of the water as a prerequisite to Appellees' obligation to build reservoirs and pipe lines" (Appellee's Br. p. 19). The effect of this limited arbitration clause is, then, that other breaches, including the repudiation of the entire contract, need not be arbitrated in any event, but would remain for determination by a court. It therefore appears most practical that the question of repudiation be determined first. Otherwise, the parties would be required to go through the arbitration concerning the quantity of the water, and thereafter to try the question of repudiation which, if decided in favor of Appellants, would render the arbitration useless. Furthermore, the value of the re-

quested arbitration is doubtful at best, because the consequences of the past delay in building the reservoirs and extending pipe lines is relatively minute when compared to the gross breaches and repudiations by Appellees.

Amplification of Appellees' Statement of the Case.

The attention of the court is respectfully directed to its holding, in the former appeal, that the District Court was in error in concluding that the contract in question was not susceptible of total breach. The breach in paying installments adjudicated by the District Court and affirmed by this court was determined without arbitration. The existence of these breaches is also relevant to the question of repudiation.

We think it important to note that in its earlier opinion the court indicated that the rationale of the decision in *Gold Mining and Water Co. v. Swinerton,* 23 Cal. 2d 19 (1943), was applicable to the contract in the present case, although the court noted that the facts in the present case did not make the seller *totally* dependent on the buyer's diligence.

From the reasoning of the court in reaching its conclusion on the earlier appeal, as well as from the conclusion itself, we urge that the contract implied an obligation to exercise diligence in developing the water lands.

At no place in Appellees' brief do they concede that under any circumstances whatever, and regardless of what an arbitration may determine, Appellees are under an obligation to produce water. Their position has been just the contrary. They have contended that while a determination in arbitration could result in the im-

position on Appellees of the obligation to build reservoirs and pipe lines, still, no matter what amount of water was found, Appellees would not be obligated to produce water.

Following is from the transcript of the hearing on the motion for arbitration:

> "The Court: Let's assume for the purpose of argument only that the water lands were not sufficient, the wells on the water lands were not sufficient to produce sufficient water to adequately service the entire 1600 acres.
>
> Then let's assume that the water produced from the wells on the water lands could have adequately serviced 500 acres, or 100 acres.
>
> Then your position is that you were not even obligated to take the water that was available even though it was available to service 100 or 500 acres of land.
>
> "Mr. Kadison: That is our position up to the point of where the difference becomes de minimis. As a matter of fact, no, not up to any point. It wouldn't have made any difference, perhaps this will focus our position, your Honor, as I read the contract, it wouldn't have made an iota of difference if the water lands had been capable of serving all 1600 acres, we would not have been obliged to pump a gallon of water. We could not have relied upon their insufficiency as an excuse for not building the pipelines and reservoir.
>
> "The Court: Let's forget the pipelines and reservoir.
>
> "Mr. Kadison: But we would not under this agreement, we are not obliged to take a single gallon of water whatever they would produce."

If Appellees meant what their counsel said, then the requested arbitration would at most have resulted in determining that Appellees were obligated to do what they have already done (though late), that is, extend pipe lines and build reservoirs, and could presumably result in an award of nominal damages; we say "nominal damages" because the reservoir and pipe lines would be of no benefit to Appellants unless water were produced. But, so Appellees maintain, they were not required to produce water.

We urge the court to hold that the request for arbitration was a comparatively meaningless procedure, *unless* Appellees should concede what until now they have stoutly denied, that Appellees were under an implied duty to develop the water lands for the mutual benefit of the contracting parties or, failing that concession, that this court should so hold.

If Appellants do not have the opportunity to benefit by the arbitration, but are still to be left to the discretionary impulses of Appellees concerning the production of water, then the arbitration and the litigation surrounding it have been a costly and enduring exercise in futility. We believe that this court will not tolerate such proceedings.

We call the court's attention to paragraph 2(b) of the 1955 agreement (Appendix, Appellants' Op. Br. pp. 4-5) dealing with the Appellees' minimum obligations after the first two years. This language, we submit, imposes a minimum obligation on Appellees to deliver money or specific quantities of water each year. We contend that this minimum is not a substitute for the obligation diligently to develop. At this point it is sufficient to say that Appellees' contention that it is

under no obligation to produce water is manifestly at odds with the contract.

We make the foregoing observation without intending to diminish our contention that Appellees have in fact repudiated the entire contract, and that the arbitration clause did not survive the repudiation.

Summary of Closing Argument.

Appellees' right to arbitration is governed by California law; under California law, provisions for arbitration are repudiated by a repudiation of the contract as a whole; at least the repudiating party may not require arbitration.

Contracts which measure royalty, price, or rent by the production of water are subject to the same logic as are similar contracts for the production of oil or gas; there is an implied covenant diligently to develop. Water is "fugaceous", not fixed in the land, as are solid minerals.

Because the payment of the purchase price depended upon the production of water, and Appellees had control of the wells, they were under an implied duty to develop the water lands.

Appellees stated to Appellant Riess that Riess would never get any water. No demand, written or otherwise, was therefore necessary.

Other subsidiary points on the appeal, the lack of Findings, and the form of the Order, will be dealt with briefly.

ARGUMENT.

I.

The District Court Properly Allowed the Amended Complaint to Be Filed; in Any Event, the Issue of Repudiation Was Necessarily Before the Court.

Appellees say that the issues of this case cannot be altered by an Amended Complaint which, they say, is inconsistent with the Judgment; by implication they contend that the allegations of defendant's repudiation should be ignored.

Appellees' statement, if correct, would fix the issues in a case once there had been a remand from an appeal. The statement is unfounded.

Only one decision is cited by Appellees as support for their statement, *Jones v. St. Paul Fire etc. Co.,* 108 F. 2d 123 (5th Cir., 1939). On the second appeal the Circuit Court discussed the propriety of filing an Amended Complaint and said:

> "If the judge had treated the amendment, duly served under Rule 5(a), as allowed, he might have considered the merits . . . His recognition of a right to amend so as to introduce such an issue was correct". (At pp. 124-125).

In the present case, this court on the previous appeal had said that while it reversed the District Court's holding that the contract was not subject to total breach, it refrained from so holding, rightly, because the issue had been excluded by the District Court. On remand, the way was open for plaintiffs to introduce the issue of repudiation.

3 Moore's Federal Practice, Par. 15.11, page 970, which is cited by Appellees, does not help Appellees' contention. Moore says: "Unless the appellate court's adjudication *precludes* amendment . . ., the grant or denial of an amendment is within the sound discretion of the District Court." (*Id.*, p. 971).

But in any event the question of plaintiff's right to file the Amended Complaint is not determinative of the question whether the issue of repudiation was before the District Court. The opinion in the former appeal held that the District Court's denial of arbitration "on the ground that the question of insufficiency *was immaterial* was erroneous". The court went on, however, to state the criteria for determining whether the defendants could have arbitration, referring to the *Bertero* case and to waiver and estoppel.

When defendants moved for arbitration, the plaintiffs filed an affidavit in opposition and alleged the facts which constituted repudiation [Clk. Tr. p. 37 *et seq.*]. Thus the issue of repudiation was unavoidably before the court as opposition to defendants' motion. The District Court, not content with the affidavits, took evidence. Significant portions of the affidavit and of the testimony given are set out in Appellants' Opening Brief at pages 17-20, and at pages 45-54.

Under California law, that evidence was most critical, and its not having been denied should be, we submit, dispositive of this appeal.

II.

The Arbitration Provision Applied Only to the Sufficiency of Water as a Prerequisite to Appellees' Obligation to Erect Reservoirs and Extend Pipe Lines; Other Provisions of the Contract Are Not Subject to Arbitration, and Are Not Conditional.

Appellees agree that arbitration is available only to determine the sufficiency of water as a prerequisite to Appellees' obligation to erect reservoirs and extend pipe lines (Appellees' Br. p. 19).

A scrupulous examination of the contract shows that no other provision is conditional; this is true of the implied duty to develop the water lands. In any event, Appellees have made it abundantly clear that they have no intention of performing any of their obligations whatever, at least until Appellants are willing to give up their stock interest in Simi Valley Development Company, and unless Appellants were willing to accept one-half of the sums due them for the preliminary installment payments.

To argue, as Appellees do, that plaintiffs were required to prove that there was sufficient water before there arose an obligation to develop the water lands is illogical and impractical. Defendants were in possession of the land; only they had the right to drill and develop, not plaintiffs; the very purpose of the transactions between plaintiffs and defendants was that defendants would develop the wells for the ultimate purpose of developing certain other lands for residential and industrial uses. The implied obligation to develop, we contend, is not conditional, but is unconditional so long as defendants retain the lands. Certainly, it

would be unjust and bordering on the absurd to impose on plaintiffs the burden of proving the existence of sufficient water before the defendants should be required to develop the water lands.

The obligation to develop is not to be determined by arbitration. The parties to this appeal are agreed that, under the contract, only the sufficiency of water as a prerequisite to the obligation to construct reservoirs and to extend pipe lines, is to be determined by arbitration, assuming, contrary to our contention, that the contract has not been repudiated.

The sufficiency of the water as a prerequisite to building the reservoirs and extending the pipe lines should be tested only after diligent development of the water lands. Otherwise, testing of the quantity of the water could be unfair and could wrongly divest the plaintiffs of the right to payment of the balance of the purchase price.

III.

The Undenied Evidence Shows Repudiation of the Contract.

Appellees profess to show that they have not repudiated the contract. This they do (at pp. 27-31 of their Brief) by listing a number of obligations which Appellees imply are all of their obligations under the contract and they then state "the extent of Appellees performance under the contract". Appellees' argument is not sound.

In the first place, implied obligations of good faith and fair dealing are not mentioned; and such obligations may be of the utmost importance.

> "If the cooperation of the other party is necessary for successful performance of an obligation, a promise to *give that cooperation,* and *not to do anything which prevents* realization of the fruits of performance, will often be implied. This is sometimes referred to as an implied covenant of good faith and fair dealing." Witkin, Summary of California Law. Contracts, Sec. 242, page 271; (italics in original).

Professor Witkin's Statement is conservative. See *San Bernardino Valley etc. Co. v. San Bernardino Valley etc. District,* 236 Cal. App. 2d 238 (1965) at page 257.

Appellees' obligation to develop the water lands is not referred to in Appellees' summary* nor do Appellees deny they failed to perform this obligation.

Furthermore, a mere recital of what Appellees have done is not necessarily sufficient to show that they have not repudiated. Repudiation is often accomplished by an omission coupled with a positive assertion that the contracting party will not perform. *Robinson v. Raquet,* 1 Cal. App. 2d 533 (1934) at pages 542-543.

Simi Valley's "Further, Separate and Third Defense" in the Answer of defendant Simi Valley Development Company to plaintiffs' First Amended Complaint, alleged that "the building of pipe lines in the manner and as provided in said agreement . . . require the performance of an illegal act . . ." [Former Record, p. 156]. It is true that this alleged defense does not go so far as to say that *all* performance by defendants was illegal; but the assertion that laying the pipe lines was

*We do not say that Appellees have ignored Appellants' contention. But the issue is argued elsewhere in Appellees' Brief.

illegal is sufficient so far as the arbitration was concerned, because the performance of that act (and building reservoirs) are the only acts concerning which an arbitration might be requested.

This pleading alone constitutes a repudiation so far as the arbitration is concerned.

The most serious aspect of Appellees' conduct was their assertions that plaintiffs must make a new contract with defendants "or else I [Riess] get nothing; they will sit on it, wait until the Metropolitan comes in, and then I am boxed in, my wells would not be worth anything, and I am out" [Rep. Tr. Vol. 3, pp. 309-310]. This testimony, not denied, indicates, we believe conclusively, that Appellees intended to and did use their greater financial resources in an effort to compel Appellants to accept less than the contract provided for.

Appellees say (Appellee's Br. p. 30) that no demand in writing was made on them for water, and accordingly they "are not in default [in performance] of this obligation". Please note that Appellees do not say that demand was not made, nor did they offer any evidence denying the plaintiffs' testimony that demand was made; nor do Apellees anywhere deny that they told Riess he would never get water. Under these circumstances, no demand whatever was necessary. The law does not require a futile formality.

In *Wood v. McDonald,* 66 Cal. 546 (1885), the court said at page 547:

> "Proof of any circumstances which would satisfy a jury that a demand would be unavailing—as a refusal by the defendant to listen to one, or a statement in advance that he will not deliver—will be sufficient to excuse proof of a demand."

See also *Merrill v. Merrill,* 95 Cal. 334 at page 338 (1892).

One of the circumstances which make demand unnecessary is an indication of abandonment. See *Licbrand v. Otto,* 56 Cal. 242 (1880).

Finally, the court is requested to consider the following: Appellees and their counsel were sufficiently sophisticated to know that a written demand for water could well be taken as an election by Appellants to forgive Appellees' conduct, and thus as a waiver of Appellants' right to accept the repudiation. Appellants did not wish to condone Appellees' behavior or to do anything which might be construed as a waiver.

IV.

The Implied Covenant of Fair Dealing Is Not Limited to Oil and Gas Contracts: Every Contract Includes an Implied Covenant That Each Party Will Do Everything Necessary to Accomplish Its Purposes.

Appellees contend that the implied covenant to produce, in contracts in which the consideration payable is measured by the amount of production, applies only to gas and oil ventures. Appellants contend that Appellees are in error. No implication concerning the contemplation of parties is necessary, because that is stated expressly in paragraph 3 of the 1955 agreement (Appendix Appellants' Op. Br. p. 6):

> "3. Subject to the physical ability of the well or wells now or hereafter located on the Water Lands to produce sufficient quantities of water so as adequately to service the lands covered by the Montgomery Contract with an adequate supply of

water, *contemplating that such lands will be developed for residential and industrial usages,* I agree . . ." (Italics ours).

Having stated their contemplation, and Appellants having sold the land for a price to be measured by the amount of water produced, Appellants urge that Appellees were under a duty to do everything, including the development of water lands, which should be reasonably necessary to carry out the stated purpose.

In *Harm v. Frasher,* 181 Cal. App. 2d 405 (1960), at page 417, the court said:

> "This covenant not only imposes upon each contracting party the duty to refrain from doing anything which would render performance of the contract impossible by any act of his own, but also the duty to do everything that the contract presupposes that he will do to accomplish its purpose."
>
> "If without the implied obligation the fruits of the contract would be denied to one of the parties, the intent that such an obligation should not exist must clearly appear from the express terms of the contract." (*Bergum v. Weber,* 136 Cal. App. 2d 389 (1955) pp. 393-394).

See also:

1 Witkin, Summary of California Law, 217.

Appellees' argument that such a contract is implied only in cases where the royalty is the sole consideration is not borne out by the decisions. In each of the decisions above cited, other considerations were involved; and this is explicitly stated in *Hartman Ranch Co. v.*

Associated Oil Co., 10 Cal. 2d 232 (1937) (quoted in Appellants' Op. Br. p. 43).

Appellants say that Appellees' argument not only renders the contract illusory with respect to 9/10ths of the cash (or water) consideration, but is contrary to the law concerning implied covenants.

Appellees' argument that the implied covenant is applicable to oil and gas transactions because of the fugaceous nature of oil and gas, does not help Appellees. Underground water, too, is fugaceous. It is found in stationary basins or in flowing underground channels (See general statement, 51 Cal. Jur. 2d 856, Water, Sec. 388; *Vineland Irrigation District v. Azusa Irr. Co.,* 126 Cal. 486 (1899); and see 3 Farnham, Water and Water Rights, pp. 2710-2716).

Water does not respect surface boundaries of ownership; any overlying landowner may syphon off as much as he may reasonably use (*Tulare Irrigation District v. Lindsay-Strathmore District,* 3 Cal. 2d 489 (1935)).

With respect to water in wells, Farnham says:

> "The right to make lawful use of one's own property regardless of the effect upon percolating water on a neighbor's land applies also in case of wells. So that one may make improvements on his property although the effect is to drain the water from his neighbor's well. And he may dig a well on his property and even sink it lower than his neighbor's well, although the result is that his neighbor's well becomes dry." (3 Farnham, Water and Water Rights, p. 2716).

Appellees' argument that a covenant will not be implied because the parties have expressly dealt with the situation does not correctly state the law. In *Bergum v. Weber,* 136 Cal. App. 2d 389 (1955), the court said:

> "*If without the implied obligation the fruits of the contract would be denied to one of the parties, the intent that such an obligation should not exist must clearly appear from the express terms of the contract.*" (*Id.* pp. 393-394). (Italics ours).

Furthermore, the argument against implication would not be available to Appellees because Appellees have asserted on numerous occasions that they would never deliver water to Appellants.

It is not credible that the delivery of the limited water was intended as a substitute for diligent development of the water lands. It is more reasonable to conclude that the delivery of limited amounts of water was a contractual alternative only if, despite diligent development of the wells, sufficient water was not produced.

See:

Bergum v. Weber, 136 Cal. App. 2d 389 at page 394.

There being no language in the contract to prevent the imposition of the implied duty to develop, and this obligation being necessary to give Appellants the fruits of their contract, the obligation diligently to develop should be implied.

In percentage rental cases it is feasible to appraise the rental value of the property and to determine whether the stated minimum rate approaches that value. This appraisal is not possible in mining cases, par-

ticularly where the mineral is fugaceous, because the value (price, rental, or royalty) depends on the quantity of production. That is the case here.

The foregoing distinguishes the decision in *Lippman v. Sears, Roebuck & Co.,* 44 Cal. 2d 136 (1955), in the respects argued by Appellees. The decision in *Cousins Investment Co. v. Hastings Clothing Co.,* 45 Cal. App. 2d 141 (1941), on examination appears to support Appellant's position. The opinion says, in part:

> "Nor is there anything in the nature of the transaction to justify a finding that the implied covenant was indispensable to effectuate the intention of the parties, nor can it be supported on the grounds of legal necessity. On the contrary, as defendant argues, it would seem that the covenant to pay the minimum rental *was inserted in the lease as a substitute for an express covenant requiring the continuous operation* of the demised premises; that when the rental reserved in a lease is based upon a percentage of the gross receipts of the business, with a substantial, adequate minimum, there is no implied covenant that the lessee will operate its business in the demised premises throughout the term of the lease." (at p. 149; italics ours).

The facts here are contrary to those in *Cousins.* Here the parties contemplated the development of the Montgomery lands by use of water from the Appellants' lands.

Kasey v. Molybdenum Corp. of America, 336 F. 2d 560 (1964), relied on by Appellee, does not in fact decide the question of implied duty to develop, but considers only the question of the Statute of Limitations (see 336 F. 2d at pp. 571-572).

Summarizing, Appellants contend that the parties contemplated the development of the Montgomery lands, and said so; that the implied duty to develop was necessary in order to yield to Appellants the benefits of the contract; and there is nothing in the contract which excludes the implied obligation; on the contrary, a determination that the implied duty was present would render the contract a reasonable one.

V.

Under California Law the Right to Arbitration Does Not Survive an Accepted Repudiation; Further, Repudiation of a Material Provision of a Contract, if Accepted as a Repudiation, Constitutes a Repudiation of the Entire Contract.

Bertero v. Superior Court, 216 Cal. App. 2d 213 (1963), is still the law of California. In that case there was no specific repudiation of the arbitration clause; the repudiation was of the entire agreement. When Bertero sued his former employer, the latter immediately moved for an order to compel arbitration. Nevertheless, the District Court of Appeal said that the employer's repudiation of the contract carried with it the arbitration clause. Following is from the opinion:

> "It is well settled that where the right to arbitrate has been in fact waived, the contract in all other respects may then be enforced in the courts. (Citations). The record before the superior court established *as a matter of law* that National had waived the right to compel arbitration and that Bertero had commenced his action in reliance upon that waiver. It was therefore an abuse of discretion for the superior court to stay the action and order the parties to arbitrate." (*Id.,* pp. 221-222).

Bertero is cited with approval in *Sawday v. Vista Irrigation,* 64 Cal. 2d 833 (1966), and in *Berman v. Renart, etc.,* 222 Cal. App. 2d 385 (1963), though in those cases the facts were different from those at bar.

The decision in *Berman, supra,* however, indicates that our reading of *Bertero* is right.

> "A right to arbitration may be waived. (Code Civ. Proc., Sec. 1281.2, subd. (a) . . .; and it is waived by a repudiation or denial *of the contract* in which the arbitration clause is contained. (*Bertero v. Superior Court* (1963) 216 Cal. App. 2d 123 [30 Cal. Rptr. 719].)" (p. 389; emphasis added).

Local 659 etc. v. Color Corp. of America, 47 Cal. 2d 189 (1956) is a most recent statement by the Supreme Court of California on the subject. Following is from the opinion:

> "A repudiation *of a contract* accepted by the promisor excuses performance by the promisee. (*Bomberger v. McKelvey,* 35 Cal. 2d 607 [220 P. 2d 729]; *Walker v. Harbor Business Blocks Co.,* 181 Cal. 773 [186 P. 356]; Civ. Code, Sec. 1511.) And it is said in *Dessert Seed Co. v. Garbus,* 66 Cal. App. 2d 838, 847 [153 P. 2d 184]:: 'It is well settled that an *abandonment of a contract may* be implied from the acts of the parties and this may be accomplished by the repudiation *of the contract* by one of the parties and by the acquiescence of the other party in such repudiation. This doctrine is supported by many cases. [Citations]'" (at p. 198; emphasis added).

In California the issue of whether a contract containing an arbitration clause is still in effect is a question for the court. *Silva v. Mercier,* 33 Cal. 2d 704, 709 (1949) holds:

> "It has been held that the issue of whether a contract containing an arbitration clause exists, or is still in effect, is not within the purview of the arbitration clause for the reason that if there is no contract there is no provision for arbitration." (Citing cases).

The decision in *Heyman v. Darwins, Ltd.* (1942), A.C. 356, contains some language which may be contrary to California law; but the decision can be distinguished from the case at bar on the ground that the arbitration clause in the English case was as broad as language could make it. "If *any* dispute shall arise between the parties hereto *in respect of this agreement* or any of the provisions herein . . .". The italicized language affords logical justification for holding that the arbitration clause survived the agreement. For example, Lord MacMillan says that in deciding this issue the first question is to determine the nature of the dispute; and he goes on to say:

> "The next question is whether the dispute is one which falls within the terms of the arbitration clause. *Then sometimes the question is raised whether the arbitration clause is still effective* or whether something has happened to render it no longer operative. Finally, the nature of the dispute being ascertained, it having been held to fall within the terms of the arbitrationn clause, *and the clause having been found to be still effective,*

there remains for the Court the question whether there is any sufficient reason why the matter in dispute should not be referred to arbitration."

Bertero was based on C.C.P. Sec. 1281.2 That section requires arbitration unless, "The right to compel arbitration has been waived by petitioner." *Bertero* held that a repudiation of the entire contract constituted a waiver of the right to arbitration, even though the petitioner asked for arbitration in its first appearance in court (see 216 Cal. App. 2d at p. 221).

In *DeLillo v. Lizza & Sons, Inc.*, 7 N.Y. 2d 102, 164 N.E. 2d 95 (1959), the arbitration clause encompassed, "all questions that may arise under this contract and in performance of the work hereunder". The lower court had relied on an earlier decision, *Young v. Crescent Dev. Co.*, 240 N.Y. 244, 148 N.E. 510; but the Court of Appeals said, "The law has been changed since then", and cited an amended section of the Lien Law (see 164 N.E. 2d 96).

In *Batter Building Materials Co. v. Kuchner*, 142 Conn. 1, 110 A. 2d 464 (1954), the court acknowledged it was departing from established law in following *Heyman v. Darwins.*

The annotation in 3 A.L.R. 2d 410 shows no California decision following the rule in *Heyman.* The California cases there cited are to the contrary (see *Farnum v. Phoenix Ins. Co.*, 83 Cal. 246 (1890); *Jacobs v. Farmers Mtl. F. Ins. Co.*, 5 Cal. App. 2d 1 (1935); *Bass v. Farmers Mtl. Prot. Co.*, 21 Cal. App. 2d 21 (1937).

In fact, the annotation referred to covers the present situation with the statement at 3 A.L.R. 2d page 421.

Appellees' reasoning seems to confuse two separate propositions. The first is that the repudiation of the right to arbitrate is required to deprive a party of that right. The second proposition is that a repudiation of the contract as a whole carries with it the repudiating party's right to demand arbitration. It appears probable that the English, New York, and Connecticut decisions are contrary to the second proposition, at least in those cases in which the arbitration clause is sufficiently broad. The California rule of decision embraces the second proposition, that is, repudiation *of the contract* deprives the repudiating party of the right to claim arbitration.

One additional principle of California law, while not essential for Appellant's position, deserves the attention of the court. In California, as in many states, a repudiation of a material provision of the contract constitutes a repudiation of the whole contract. In *Alderson v. Houston,* 154 Cal. 1 (1908), the curt said:

> "It was a breach of a material part of an entire contract; 'the first breach by the defendant was a breach of the whole and discharged the plaintiffs from performance of any conditions on his part.'" (at p. 10).

See also:

McManus v. Bendlage, 82 Cal. App. 2d 916 (197) at page 924;

Compania Engraw v. Schenley Dist. Corp., 181 F. 2d 876 (9th Cir. 1950) at p. 878;

Orton v. Embassy Realty Associates, 91 Cal. App. 2d 434 (1949) at p. 438;

Steel Duct Co. v. Henger-Seltzer Co., 26 Cal. 2d 634, 160 P. 2d 804 (1945);

Loop Building Co. v. De Coo, 97 Cal. App. 354 (1929), at p. 364, on the effect of annexing an unwarranted condition;

Alphonzo E. Bell Corp. v. Listle, 74 Cal. App. 2d 638 (1946);

Alderson is also cited in *Big Boy D. Corp., Ltd. v. Etheridge,* 44 Cal. App. 2d 114, 121 (1941); *Adams v. Hiner,* 46 Cal. App. 2d 681, 683 (1941); *Abraham Lehr, Inc. v. Cortez,* 57 Cal. App. 2d 973, 978 (1943).

There is no reason to believe that the decisions above cited are not now the law in California. The repudiation by Appellees' conduct, breaches, and assertions here and elsewhere stated amounted to a repudiation of the entire contract. The fact that Appellees did not say specifically that they would not arbitrate cannot save that right because they indicated by their conduct that they had no intention of performing the most material parts of the contract.

Appellees' position on this point comes to this: they contend that they have the right to abandon development of the water lands, to apply economic duress, and to renounce their obligations under the contract; but when Appellants apply to the court for relief, Appellees demand arbitration and a stay of judicial proceedings. That position is not consistent with California law.

VI.

Findings of Fact Were Required; the District Court's Failure to Make Findings Is Reversible Error.

Appellants recognize that this is a subsidiary point on this appeal. The point would be of value to all parties if this court were to hold, as Appellants contend, that a repudiation of the entire contract, or of a material provision of it, would deprive Appellees of the right to demand arbitration of what is a minimal item; on such a holding by this court, if this court should nevertheless not find in accordance with Appellants' contention that Appellees had repudiated the contract, the issue of repudiation would be tried, and Findings of Fact would be made. At present there are no Findings concerning repudiation.

Appellees' position is that the decision in *Baltimore Contractors v. Bodinger*, 348 U.S. 176 (1955) overruled *Shanferoke Coal etc. v. Westchester Service Corp.*, 293 U.S. 449 (1935). We submit that Appellees' position is erroneous.

Although *Baltimore* cites *Shanferoke*, *Baltimore* does not expressly or otherwise overrule *Shankeroke*. The facts in *Baltimore* were different, and a majority of the court, through recognizing the dubious significance of the difference, though that a different rule should be applicable to the situation in *Baltimore*.

In *Baltimore* the court found that the contractual provisions "did not constitute an agreement to arbitrate". (348 U.S. at p. 77), and thus refused to grant a stay. The Supreme Court said of this:

> "Whether the District Court was right or wrong in its ruling that the contract provision did not

> require arbitration proceedings, it was simply a ruling in the only suit pending, actual or fictional. . . . This present case is to be distinguished from the Shanferoke Coal & Supply Corp. Case, 293 U.S. 449, 79 L. Ed. 583, 55 S.Ct. 313, supra, note 5, in the same way. There is a *common-law action* a motion for an interlocutory injunction on an equitable defense was refused." (348 U.S. at 184).

Shanferoke was an action on a contract, not an action in equity. The only thing in the case which was equitable in nature was the special defense of arbitration. Following is from the opinion in *Shanferoke:*

> "We are of the opinion that the special defense setting up the arbitration agreement is an equitable defense or cross-bill within the meaning of Sec. 274b; and that the motion for a stay is an application for an interlocutory injunction based on the special defense." (79 L. Ed. 586).

Baltimore is not inconsistent because the agreement sued on, so it was held, did not constitute an agreement to arbitrate.

In any event, Appellees "Notice of Motion to Stay Proceedings Pending Arbitration" [Clk. Tr. p. 22, *et. seq.*] was, in effect, the interposition of an equitable defense as in *Shanferoke.*

Carey v. Carter, 344 F. 2d 567 (1965), which we have cited in our Opening Brief, was decided after *Baltimore;* presumably that court knew the *Baltimore* decision and understood the distinction between the facts in *Baltimore* and the facts in *Shanferoke.*

The failure to make Findings therefore constituted reversible error.

VII.

The Record Shows That the District Court Did Not Consider the Question of Repudiation; the "Finding" That Defendants Were Not in Default Was Erroneous.

Appellees deal with Appellants' argument on this point as though the only issue were one of language. Appellants' argument is primarily one of substance, the announced refusal by the District Court to consider the question of repudiation on the hearing for arbitration [Rep. Tr. Vol. 5, p. 673], and that repudiation was breach indeed. Appellees have dealt with substantive questions elsewhere, and accordingly Appellants believe no further reply is necessary here, except to point out that even if this court should hold against Appellants on all other points, the order of the District Court should be clarified to prevent unintended injury to plaintiffs.

Conclusion.

Appellees complain (at p. 15 of their Brief) that Appellants have made "inflammatory remarks". But it is natural for persons who have been badly hurt to cry out; just as it is the practice of those wto wish to use the law as a means of delay to demand every procedural punctilio and if possible to defer substantive determinations. Here Appellees seek arbitration of a miniscule point (the determination of damages for past delay in their building reservoirs, etc.), and have obtained a stay of all judicial proceedings until that arbitration is completed.

Appellants have parted with their land and have otherwise fully performed. The letter of Simi Valley

(quoted at pp. 10 and 11 of Appellees' Br.) sets out the contours of this case. That letter says that if Appellants are not willing to give up their stock interest and to accept only one-half of the instalments due, then Simi will demand arbitration. Stated more generally, and directly relevant to this appeal, the letter says, Now that you have done all required of you under the contract, you must give up substantial rights; if you refuse, we shall exercise our rights under the contract to arbitrate, litigate, and we will cause you ultimately to meet our terms. The evidence below substantiates this construction.

Arbitrations are usually designed to determine the existence and effect of breaches. Not so here. The arbitration was to determine the sufficiency of water only as a prerequisite to extending pipe lines and building reservoirs. Furthermore, a repudiation or renunciation of a contract, as was proved here, cannot be the subject of an arbitration. To arbitrate there must be an agreement to submit.

This court should not allow the procedural aspects of the law to be paramount to the administration of justice. A reversal with direction to find that Appellees have repudiated would be right. If the court is unwilling to make that determination on this record, the case should be reversed with instructions permitting defendants to file their Answer to the Complaint, and directing that the issue of repudiation be tried first in order to determine whether there still remains an agreement to submit to arbitration.

Respectfully submitted,

MORRIS E. COHN,
Attorney for Appellants.

Certificate.

I certify that, in connection with the preparation of this brief, I have examined Rules 18, 19 and 39 of the United States Court of Appeals for the Ninth Circuit, and that, in my opinion, the foregoing brief is in full compliance with those rules as modified by the Order of this court filed March 14, 1967.

MORRIS E. COHN